

Message Text

CONFIDENTIAL

PAGE 01 ROME 03262 01 OF 04 211856Z
ACTION EUR-08

INFO OCT-01 SS-14 ISO-00 EB-04 NSC-05 INR-05 CIAE-00
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C O N F I D E N T I A L SECTION 1 OF 4 ROME 3262

LIMDIS

E.O. 11652: GDS
TAGS: ECON, EFIN, ELAB, PINT, IT
SUBJECT: ECONOMIC ISSUES, THE NEW GOVERNMENT, AND THE IMF

REF: A. ROME 3069, B. ROME 1560

1. SUMMARY. THE IMF IS SCHEDULED TO SEND A MISSION TO ITALY BEFORE APRIL TO REVIEW ITALY'S ECONOMIC PERFORMANCE UNDER THE 1977-78 STAND-BY AGREEMENT AND TO DISCUSS POSSIBLE REVISION OF STAND-BY TARGETS OR NEGOTIATING NEW AGREEMENT. AN ECONOMIC PROGRAM IS NOW BEING NEGOTIATED BY THE POLITICAL PARTIES AS PART OF THE PROCESS OF TRYING TO FORM A NEW GOVERNMENT. IF AN ECONOMIC PROGRAM IS AGREED UPON BY THE PARTIES, IT WILL ESTABLISH THE FRAMEWORK FOR ECONOMIC POLICIES OF THE NEW GOVERNMENT AND, BY THE SAME TOKEN, CONDITION THE FLEXIBILITY OF THE GOI IN ITS DISCUSSION WITH THE IMF. WE BELIEVE IT IS ESSENTIAL FOR ITALY TO CONTINUE ON THE PATH OF MODEST GROWTH COMBINED WITH SERIOUS EFFORTS TO SOLVE SOME OF THE STRUCTURAL PROBLEMS WHICH PLAGUE ITS ECONOMY. WHILE THERE IS A GROWING CONSENSUS AMONG THE POLITICAL PARTIES, INCLUDING THE PCI, AND THE TRADE UNION MOVEMENT--ALTHOUGH
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PAGE 02 ROME 03262 01 OF 04 211856Z

OBVIOUSLY DICTATED IN PART BY POLITICAL CONSIDERATIONS-- ON THE ISSUES TO BE ADDRESSED AND TYPES OF SOLUTIONS REQUIRED, A WIDE GULF REMAINS BETWEEN THIS AGREEMENT ON GENERAL PRINCIPLES AND ONE ON SPECIFIC MEASURES. ALTHOUGH TIMING AND NATURE OF IMF DISCUSSIONS WITH GOI WILL DEPEND LARGELY ON POLITICAL DEVELOPMENTS, WE BELIEVE THERE WILL BE ROOM FOR IMF TO REINFORCE TENDENCY TOWARD APPROPRIATE

POLICIES IN SUCH CRITICAL AREAS AS PUBLIC DEFICIT, LABOR COSTS AND EMPLOYMENT-CREATING INVESTMENT. END SUMMARY.

2. FUNDAMENTAL PROBLEM AND RECOMMENDED PROGRAM

A. PROBLEM. THE FUNDAMENTAL ECONOMIC PROBLEM FACING THE NEXT GOVERNMENT IS HOW TO GET THE ECONOMY ON A SUSTAINABLE GROWTH PATH SO THAT IT CAN PROVIDE MORE JOBS WHILE AVOIDING THE RESURGENCE OF INFLATIONARY PRESSURES AND BALANCE OF PAYMENTS DIFFICULTIES. THE PROBLEM IS A PARTICULARLY DIFFICULT ONE BECAUSE THE EXPERIENCE OF THE PAST FEW YEARS DEMONSTRATES THAT THE ECONOMY IS CAUGHT UP IN A DIFFICULT STOP/GO SITUATION. THE AUTHORITIES HAVE SO FAR NOT BEEN ABLE TO IMPLEMENT A CONSISTENT SET OF POLICIES WHICH WILL SIMULTANEOUSLY PROVIDE EXTERNAL STABILITY AND NON-INFLATIONARY GROWTH SUFFICIENT TO COPE WITH THE UNEMPLOYMENT PROBLEM. THE BASIC REASON FOR THIS IS THAT THE ECONOMY IS BURDENED WITH A NUMBER OF STRUCTURAL PROBLEMS, PARTICULARLY WITH A LARGE PUBLIC SECTOR DEFICIT AND A SYSTEM OF WAGE INDEXATION WHICH IS HIGHLY INFLATIONARY.

B. RECOMMENDED PROGRAM. WE BELIEVE THE DESIRABLE ECONOMIC SCENARIO FOR THE NEXT GOVERNMENT IS THE FOLLOWING:

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PAGE 03 ROME 03262 01 OF 04 211856Z

(1) FOCUS ON THE LONGER-RANGE PROBLEMS OF THE ECONOMY. THE NEXT GOVERNMENT SHOULD BEGIN THE PROCESS OF MAKING A SIGNIFICANT DENT IN THE RELATIVE SIZE OF THE PUBLIC SECTOR DEFICIT, AND BRINGING INCREASES IN PER UNIT LABOR COSTS DOWN TO EC AVERAGE. WHILE THIS PROCESS MAY TAKE A FEW YEARS TO COMPLETE, A SERIOUS BEGINNING WOULD HAVE AN ENORMOUSLY FAVORABLE IMPACT ON BUSINESS PSYCHOLOGY. AT THE SAME TIME, PROGRESS IN THIS DIRECTION WOULD SET IN MOTION WHAT EVERYBODY AGREES IS THE FUNDAMENTAL ADJUSTMENT NEEDED IN THE ITALIAN ECONOMY, I.E., SHIFTING RESOURCES OUT OF CONSUMPTION AND INTO INVESTMENTS AND EXPORTS.

(2) AIM FOR A GROWTH RATE IN 1978 IN THE 2-3 PERCENT RANGE AND HOPE TO GET IT UP TO AT LEAST 4.0 PERCENT IN 1979. OUR RECOMMENDED GROWTH TARGET FOR 1978 IS AN AVERAGE, WHICH MEANS THAT BY THE FOURTH QUARTER THE ECONOMY WILL ALREADY BE GROWING AT CLOSE TO 4.0 PERCENT. THE REASONS FOR SUGGESTING THIS LOW-GROWTH SCENARIO ARE: (A) WE RULE OUT CONSUMPTION-LED STIMULUS ACTIONS (WHICH WOULD BE CONNECTED WITH A LARGER DEFICIT) AS UNDESIRABLE, AND (B) WHILE INCREASING PUBLIC IN-

VESTMENTS IS A POSSIBILITY IN THEORY, IN PRACTICE--
GIVEN THE BUREAUCRATIC RED TAPE INVOLVED--NOT MUCH CAN
BE DONE THAT WOULD IMPACT IN 1978. ASSUMING SOME
PROGRESS IN REDUCING THE PUBLIC SECTOR DEFICIT AS A
PERCENT OF GDP FOR 1979 AND IN GETTING LABOR TO ACCEPT
MODEST WAGE ADJUSTMENTS IN THIS FALL'S NEGOTIATIONS,
THEN FOR 1979 ONE CAN EXPECT MORE ECONOMIC STIMULUS
COMING FROM INVESTMENTS, BOTH PRIVATE AND PUBLIC,
AND LESS FROM CONSUMPTION--A MORE DESIRABLE FORM
OF GROWTH.

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PAGE 01 ROME 03262 02 OF 04 211908Z

ACTION EUR-08

INFO OCT-01 SS-14 ISO-00 EB-04 NSC-05 INR-05 CIAE-00

NSAE-00 SP-02 OMB-01 IGA-01 L-01 SIL-01 DODE-00

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FM AMEMBASSY ROME

TO SECSTATE WASHDC PRIORITY 756

TREASURY DEPT WASH DC PRIORITY

C O N F I D E N T I A L SECTION 2 OF 4 ROME 3262

LIMDIS

(3) OUR RECOMMENDED STRATEGY IS CONSISTENT
WITH A CURRENT ACCOUNT SURPLUS AND SOME FURTHER
REDUCTION IN THE RATE OF INFLATION THIS YEAR. WHILE
A GROWTH RATE OF ABOUT 4.0 PERCENT BY THE FOURTH
QUARTER WOULD PROBABLY PUT THE CURRENT ACCOUNT INTO
DEFICIT BY THEN, WE ESTIMATE A SURPLUS ON THE ORDER OF
\$1.5-2.0 BILLION FOR THE YEAR. ON THE OTHER HAND,
INFLATION SHOULD COME DOWN TO THE 12-14 PERCENT
RANGE. FOR 1979, ASSUMING A GROWTH RATE OF ABOUT
4.0 PERCENT (AVERAGE), WE FORECAST A CURRENT ACCOUNT
DEFICIT ON THE ORDER OF \$1.0 BILLION WITH THE EX-
PECTED UPSWING IN THE INVENTORY CYCLE PUTTING PRES-
SURES ON IMPORTS. BARRING MAJOR PROBLEMS, INFLATION
SHOULD BE REDUCED BELOW THE DOUBLE-DIGIT LEVEL IN
1979.

(4) DURING 1978 AND 1979, ITALY WILL HAVE
TO REPAY \$7.5-8.0 BILLION IN FOREIGN DEBTS, OF WHICH

\$5.0 BILLION IN 1978. TO MAKE SUCH REPAYMENTS, ITALY WILL PROBABLY WANT TO BORROW ADDITIONAL SUMS, SINCE IT IS UNLIKELY THAT IT WILL WANT TO PART WITH ANY OF ITS GOLD HOLDINGS. IN ADDITION, THERE IS AN
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PAGE 02 ROME 03262 02 OF 04 211908Z

OVERHANG OF ABOUT \$6.7 BILLION IN THE FORM OF FOREIGN BORROWING BY COMMERCIAL BANKS WHICH REPRESENTS A POTENTIAL DRAIN ON OFFICIAL RESERVES. THE KIND OF STRATEGY RECOMMENDED IS THE ONE MOST LIKELY TO RECEIVE THE APPROVAL AND SUPPORT OF FOREIGN LENDERS, INCLUDING THE IMF, EC AND PRIVATE CREDITORS, WHICH WOULD HAVE TO FINANCE ITALY.

C. RECOMMENDED ECONOMIC PACKAGE

(1) BUDGET DEFICIT: THE ANTICIPATED ENLARGED BUDGET DEFICIT FOR 1978 WAS LAST OFFICIALLY ESTIMATED AT 29,650 BILLION LIRE. AS A PROPORTION OF GDP, THIS MEANS A 2-3 PERCENTAGE POINT INCREASE ABOVE THE ESTIMATED 1977 LEVEL. MEASURES HAVE ALREADY BEEN TAKEN WHICH WILL REDUCE IT TO 27,350 BILLION LIRE. ANDREOTTI'S PROPOSAL AIMS AT A DEFICIT OF 24,000 BILLION LIRE. SINCE THE LONGER-TERM OBJECTIVE IS TO REDUCE THE BUDGET DEFICIT AS A PROPORTION OF GDP, WE BELIEVE THIS IS A GOOD TARGET. ON THE OTHER HAND, IT MAY BE DIFFICULT TO REACH IT SINCE ALMOST ALL, IF NOT ALL, OF THE REDUCTIONS WOULD HAVE TO BE MADE IN THE SECOND HALF OF THIS YEAR.

(2) THE MOST EFFICIENT WAY TO ATTACK THE DEFICIT IN 1978 AND BEYOND IS BY REDUCING GOVERNMENT TRANSFER PAYMENTS AND BY INCREASING PUBLIC SERVICES TARIFFS. A LARGE INCREASE IN DIRECT TAXES DOES NOT SEEM SENSIBLE, SINCE ITALY'S FISCAL BURDEN HAS COME CLOSE TO THE POINT WHERE IT COULD ADVERSELY AFFECT INCENTIVES.

(3) THE MOST OBVIOUS AREAS TO OPERATE ON
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PAGE 03 ROME 03262 02 OF 04 211908Z

TO CONTAIN THE DEFICIT ARE PENSIONS, HEALTH AND WELFARE, LOCAL AUTHORITY EXPENDITURES AND DEFICITS OF AUTONOMOUS AGENCIES, INCLUDING ENEL (NATIONAL ELECTRICAL AGENCY). THE PENSION FUND DEFICIT CAN BE QUICKLY REDUCED BY EQUALIZING METHODS OF CONTRIBUTIONS,

MAKING SELF-EMPLOYED AND AGRICULTURAL WORKERS CONTRIBUTE ON THE SAME BASIS AS WAGE AND SALARY EARNERS, BY CHANGING THE SYSTEM OF INDEXATION OF PENSIONS WHICH NOW PERMITS SOME PENSIONS TO RISE BY A MULTIPLE OF INFLATION, AND BY TIGHTENING CRITERIA FOR ISSUING PENSIONS TO "INVALIDS" WHICH HAVE REALLY TAKEN THE FORM OF A WELFARE PROGRAM. HEALTH AND WELFARE OUTLAYS CAN BE CUT BY CHARGING USERS A MINIMUM FEE ("TICKET SYSTEM") FOR DRUGS AND HEALTH CARE; A SYSTEM ALONG THESE LINES HAS ALREADY BEEN PRESENTED TO PARLIAMENT. ALSO, THE DEFICIT CAN BE REDUCED BY INCREASING ENEL AND RAILWAY RATES. FINALLY, THE DEFICIT OF LOCAL AUTHORITIES CAN BE REDUCED BY PLACING A CEILING ON LOCAL GOVERNMENT EXPENDITURES, AS HAS BEEN PROPOSED IN LEGISLATION PASSED BY THE CHAMBER OF DEPUTIES.

CONFIDENTIAL

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PAGE 01 ROME 03262 03 OF 04 211945Z
ACTION EUR-08

INFO OCT-01 SS-14 ISO-00 EB-04 NSC-05 INR-05 CIAE-00
NSAE-00 SP-02 OMB-01 IGA-01 L-01 SIL-01 DODE-00
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TREASURY DEPT WASH DC PRIORITY

C O N F I D E N T I A L SECTION 3 OF 4 ROME 3262

LIMDIS

(4) LABOR COST: THE POSSIBLE GOAL TO SHOOT FOR ON PER UNIT LABOR COSTS IS TO KEEP INCREASES IN ITALY FOR THE NEXT TWO YEARS TO THOSE OF ITALY'S MAIN TRADING COMPETITORS. INII EXCHANGE FOR SUCH A COMMITMENT, LABOR UNIONS WILL REQUIRE A COMMITMENT ON INCREASING EMPLOYMENT. TO ACHIEVE SUCH A TARGET WOULD THUS REQUIRE A "SOCIAL PACT" INVOLVING UNIONS, INDUSTRIALISTS, POLITICAL PARTIES, AND THE GOVERNMENT. ALTHOUGH THE UNIONS HAVE SPECIFICALLY REJECTED IDEA OF "SOCIAL PACT," THE POSSIBILITY OF ACHIEVING THE SAME OBJECTIVE WITH DIFFERENT TERMINOLOGY SHOULD

NOT BE EXCLUDED.

3. POLITICAL DIMENSIONS

A. THE DEBATE ON ITALIAN ECONOMIC POLICY HAS CENTERED IN RECENT WEEKS IN THE NEGOTIATIONS AMONG THE POLITICAL PARTIES FOR THE FORMATION OF A NEW GOVERNMENT. THERE HAS BEEN GENERAL AGREEMENT AMONG THE PARTIES THAT THEY MUST TAKE AS A POINT OF DEPARTURE THE PROGRAMMATIC ACCORD CONCLUDED BY THE SIX PARTIES OF THE "CONSTITUTIONAL ARC." IN ITS EXISTING FORM, CONFIDENTIAL

CONFIDENTIAL

PAGE 02 ROME 03262 03 OF 04 211945Z

THOSE PORTIONS OF THE PROGRAMMATIC ACCORD COVERING ECONOMIC POLICY ARE VERY VAGUE AND OF LITTLE GUIDE TO ECONOMIC POLICY BEYOND IDENTIFICATION OF AREAS REQUIRING GOVERNMENTAL ACTION. THE VERSION OF THAT ACCORD COMING OUT OF PRESENT NEGOTIATIONS, ASSUMING THEY LEAD TO FORMATION OF A NEW GOVERNMENT, WILL SET TONE AND OUTLINE OF ECONOMIC POLICY IN COMING MONTHS.

B. THESE DISCUSSIONS AND NEGOTIATIONS ON ECONOMIC POLICY TAKE PLACE IN CONTEXT OF AN INCREASING CONSENSUS AMONG POLITICAL PARTIES AND LABOR MOVEMENT ON URGENCY OF ATTACKING STRUCTURAL PROBLEMS AND ON GENERAL DIRECTION OF REQUIRED GOVERNMENT POLICY INsofar AS LABOR IS CONCERNED. THIS IS SEEN IN LA REPUBBLICA INTERVIEW OF CGIL LEADER LAMA (REF B) AND APPROVAL BY NATIONAL LABOR ASSEMBLY ON FEBRUARY 15 OF LABOR CONFEDERATIONS' MODERATE POLICY DOCUMENT (ROME 3075). THIS MORE FLEXIBLE ATTITUDE BEING EXPRESSED BY LABOR, HOWEVER, IS PROBABLY PREDICATED ON THE ASSUMPTION THAT THE PCI WILL PARTICIPATE IN THE MAJORITY SUPPORTING THE NEW GOVERNMENT. ON POLITICAL PARTY FRONT HERE APPEARS TO BE BASIC CONVERGENCE, AT LEAST IN TERMS OF OVERALL ECONOMIC POLICIES, BETWEEN DC AND PCI.

C. NONETHELESS, THERE IS A WIDE GULF BETWEEN ACCEPANCE OF GENERAL PRINCIPLES AND AGREEMENT ON DETAILED MEASURES. THE ECONOMIC PORTION OF ANDREOTTI'S PROPOSED PROGRAM, SUBMITTED TO THE OTHER PARTIES ON FEBRUARY 14 (REF A), RECONFIRMS THIS POINT. THE PROGRAM PROVIDES A GENERAL POLICY FRAMEWORK AND LISTS A NUMBER OF AREAS IN WHICH ACTION MUST BE TAKEN, MOST OF THEM WITH OVERALL TARGETS AND SOME WITH CONFIDENTIAL

CONFIDENTIAL

PAGE 03 ROME 03262 03 OF 04 211945Z

FAIRLY SPECIFIC DETAILS ON PROPOSED ACTION. HOWEVER, SOME AREAS, NOTABLY THE CRITICAL ONE OF LABOR COSTS, ARE DEALT WITH ONLY IN VERY GENERAL TERMS. THE INITIAL REACTION OF THE PCI TO ANDREOTTI'S PROGRAM HAS BEEN NEGATIVE AND NON-SPECIFIC, A FURTHER INDICATION OF THE DIFFICULTIES INVOLVED IN UNDERTAKING A SERIOUS DISCUSSION OF THE ECONOMIC ISSUES.

D. MORE PARTICULARLY, THE PROPOSED PROGRAM HIGHLIGHTS THE FACT THAT A LOW GROWTH ECONOMIC POLICY COUPLED WITH ACTION ON STRUCTURAL PROBLEMS, LARGELY THOSE OF LABOR COSTS AND PUBLIC DEFICIT, IS POLITICALLY UNPOPULAR AND THAT THEREFORE BOTH THE DC AND PCI WILL EACH SEEK TO MINIMIZE THE POLITICAL DAMAGE OF SUCH MEASURES. THE RESOLUTION OF THE PUBLIC DEFICIT PROBLEM IS A CLEAR CASE IN POINT. THE PUBLIC DEFICIT CAN BE REDUCED BY INCREASING THE COSTS OF PUBLIC SERVICES BUT, FROM A POLITICAL POINT OF VIEW, IT IS OF GREAT IMPORTANCE TO KNOW WHO INCREASES WHICH COST. FOR EXAMPLE, THERE IS A GREAT DIFFERENCE BETWEEN A DC-RUN NATIONAL GOVERNMENT INCREASING THE COST OF ELECTRICITY, GAS, TELEPHONE, AND RAILWAY FARES FOR THE ENTIRE COUNTRY AND LOCAL ADMINISTRATIONS DOMINATED BY THE PCI AND THE PSI INCREASING THE COST OF LOCAL TRANSPORTATION AND OTHER PUBLIC SERVICES. IN ADDITION, THE MOST SERIOUS AND COSTLIEST ABUSES OF THE PENSION SYSTEM OCCUR WITHIN STRONG DC CONSTITUENCIES SUCH AS THE SELF-EMPLOYED, THE AGRICULTURE SECTOR AND THE DEPRESSED SOUTH, AND ANY "CORRECTIONS" ARE APT TO STIMULATE RESENTMENT AGAINST THE DC-RUN GOVERNMENT. ALTHOUGH THERE ARE A NUMBE OF UNUSUALLY HIGH PENSIONS, MOSTLY FOR RETIRED EXECUTIVES OF STATE-OWNED OR STATE-CONTROLLED COMPANIES, THE GREAT BULK OF PENSIONERS SURVIVE AT A MUCH LOWER LEVEL WHERE EVERY LIRA COUNTS.

CONFIDENTIAL

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PAGE 01 ROME 03262 04 OF 04 212014Z

ACTION EUR-08

INFO OCT-01 SS-14 ISO-00 EB-04 NSC-05 INR-05 CIAE-00

NSAE-00 SP-02 OMB-01 IGA-01 L-01 SIL-01 DODE-00

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TREASURY DEPT WASH DC PRIORITY

C O N F I D E N T I A L SECTION 4 OF 4 ROME 3262

LIMDIS

E. EQUALLY IMPORTANT IS THE POLITICAL CONSEQUENCE OF ACTIONS ON LABOR COSTS. LABOR AND THE PCI HAVE SHOWN INCREASING RECOGNITION OF NECESSITY TO LIMIT LABOR COST INCREASES. HOWEVER, THEY HAVE DIRECTLY TIED THIS TO NEED FOR JOB CREATION. INDEED, THE PROBLEM OF UNEMPLOYMENT, WHICH IS ALMOST ENTIRELY A PROBLEM OF FIRST JOB SEEKERS, IS ONE OF THE MOST DIFFICULT AND SENSITIVE POLITICAL-ECONOMIC ISSUES IN THE COUNTRY. THE LEGAL PROTECTIONS WHICH UNIONIZED JOB HOLDERS HAVE, WHICH TEND TO EXCLUDE FIRST-TIME JOB SEEKERS FROM EMPLOYMENT, ARE NOT LIKELY TO BE CHANGED. THUS, THE ONLY POSSIBLE SOURCE OF EMPLOYMENT FOR FIRST-JOB SEEKERS IS NEW JOBS, WHICH NECESSARILY IMPLIES ADDITIONAL INVESTMENTS, PARTICULARLY FO THE LABOR-INTENSIVE KIND. ONE POSSIBLE INVESTMENT INCENTIVE WOULD BE THROUGH ACCELERATED DEPRECIATION AND GREATER CREDIT AVAILABILITY, BUT IT IS QUESTIONABLE WHETHER THE PCI, PSI, AND THE TRADE UNIONS WOULD SUPPORT SUCH AN ENCOURAGEMENT OF PRIVATE INVESTMENT. IN GENERAL, THEIR TENDENCY HAS BEEN TOWARD AN EXPANSION OF THE PUBLIC SECTOR AND A CONCOMITANT REDUCTION OF THE PRIVATE SECTOR IN PART SINCE THEY BELIEVE, RIGHTLY OR WRONGLY, THAT THE PUBLIC SECTOR IS A MORE CONFIDENTIAL

CONFIDENTIAL

PAGE 02 ROME 03262 04 OF 04 212014Z

SECURE EMPLOYER.

F. FINALLY, PROBLEM OF OBTAINING AGREEMENT ON ECONOMIC POLICY IS DIRECTLY RELATED TO POLITICAL PROCESS OF FORMING A NEW GOVERNMENT. PCI WILL UNDOUBTEDLY SEEK TO YIELD LEAST POSSIBLE ON ECONOMIC PROGRAM FOR AGREEMENT ON FORMATION OF NEW GOVERNMENT. CLEARLY, THE CONTINUATION OF STABILIZATION PROGRAM AND PROGRESS ON STRUCTURAL ISSUES WILL REQUIRE ASSENT OF PCI AND LABOR UNIONS. THAT ASSENT WILL UNDOUBTEDLY REQUIRE DC TO GIVE PCI LARGER ROLE IN THE GOVERNING PROCESS THAN IT WOULD WISH. IF A POLITICAL DEAL IS STRUCK, HOWEVER, RESULTING GOVERNMENT WILL OBVIOUSLY BE VERY FRAGILE POLITICALLY AND MAY END UP WITH ECONOMIC PROGRAM THAT MEETS THE LOWEST COMMON DENOMINATOR OF THE VARIOUS PARTICIPATING PARTIES, WHICH MAY BE LESS THAN WHAT IS DESIRABLE TO GET THE ECONOMY ON A SUS-

TAINABLE GROWTH PATH.

4. ROLE OF THE IMF

A. UNDER TERMS OF EXISTING STAND-BY AGREEMENT WHICH RUNS THROUGH 1978, IMF IS SCHEDULED TO CONDUCT PERIODIC REVIEW OF ITALIAN PERFORMANCE UNDER THE EXISTING STAND-BY BY APRIL. UNDER NORMAL CIRCUMSTANCES, DISCUSSIONS WOULD HAVE CENTERED AROUND REVISING TARGETS IN PRESENT LETTER OF INTENT, PARTICULARLY ON CREDIT EXPANSION AND PUBLIC SECTOR DEFICIT. HOWEVER, SOME GOI OFFICIALS APPEAR TO FAVOR A NEW STANDBY COVERING 1978 AND 1979. ARRIVAL OF IMF TEAM WILL UNDOUBTEDLY HAVE TO WAIT FORMATION OF NEW GOVERNMENT OR BE LIMITED TO INFORMAL TECHNICAL MISSION, E.G., IF PARLIAMENT IS DISSOLVED. ON OTHER HAND, CONFIDENTIAL

CONFIDENTIAL

PAGE 03 ROME 03262 04 OF 04 212014Z

FORMATION OF NEW GOVERNMENT, WHICH WOULD BE RECOGNIZED AS HAVING LIMITED LIFE, WOULD RAISE QUESTION WHETHER IMF COULD NEGOTIATE AGREEMENT EXTENDING BEYOND 1978.

B. EVEN THOUGH ECONOMIC PACKAGE OF NEW GOVERNMENT WILL PRESUMABLY BE IN PLACE BY THE TIME THE IMF TEAM ARRIVES, AS NOTED ABOVE, MANY ISSUES ARE LIKELY TO BE ADDRESSED IN GENERAL TERMS, THUS GIVING AMPLE NEGOTIATING ROOM TO THE FUND. THE AREAS IN WHICH THE IMF CAN HAVE AN IMPACT ARE:

(1) BUDGET DEFICIT. THE FUND CAN ATTEMPT TO INSERT THE 24,000 BILLION LIRE IN THE LETTER OF INTENT AND PUSH THE GOVERNMENT INTO MAKING THE TOUGH DECISIONS (ON PENSIONS, HEALTH CARE, LOCAL GOVERNMENT EXPENDITURES) STILL REQUIRED TO BRING THE 1978 DEFICIT TO THIS LEVEL. ALSO, THE FUND MAY CONSIDER IMPOSING CONDITIONS ON HOW SUCH A DEFICIT IS TO BE FINANCED.

(2) DOMESTIC EXPENDITURES: CONTINUE TO PRESS FOR A REDUCTION IN PUBLIC EXPENDITURES AT THE NATIONAL AND LOCAL LEVEL BY PLACING SPECIFIC LIMITS ON CURRENT EXPENDITURES.

(3) LABOR COSTS. TAKING ADVANTAGE OF THE RECENTLY-EXPRESSED POLICY OF MODERATION BY LABOR UNIONS TO LIMIT WAGE INCREASES, THE FUND MAY SEEK FROM THE GOI A SPECIFIC COMMITMENT TO KEEP INCREASES IN PER UNIT LABOR COST IN LINE WITH THOSE OF EC COUNTRIES.

(4) DOMESTIC CREDIT EXPANSION. THE IMF

USUALLY PUTS A LIMIT ON DOMESTIC CREDIT EXPANSION,
WHICH IS ANOTHER LEVER IT CAN TURN TO ASSURE THAT
CERTAIN TARGETS ARE MET, PARTICULARLY INFLATION TARGET.

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PAGE 04 ROME 03262 04 OF 04 212014Z

(5) BALANCE OF PAYMENTS. IT IS STANDARD IMF
PRACTICE TO SET A CURRENT ACCOUNT BALANCE WHICH IS AN
EFFECTIVE WAY TO FORCE A COUNTRY TO BE CONCERNED ABOUT
ITS INTERNATIONAL COMPETITIVENESS AND THUS FOLLOW A
RATIONAL EXCHANGE RATE POLICY.GARDNER

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